



Tips for Evaluating a Commercially Useful Function

One particular element, out of many in the certification programs, has the most detrimental impact on the ability of a contracting entity or prime contractor to meet a contract goal. This element is the Commercially Useful Function or "CUF." How can just one element of the program have such an impact in achieving the results Congress intended when it established the disadvantaged business certification programs?

The state of Oregon, as a whole, benefits when a certified firm working on a contract performs a CUF. To establish compliance, contracting agencies using certified firms to meet a project goal should perform CUF reviews. Under the terms established in 49 CFR §26.55, a certified firm performs a CUF when it is:

"Responsible for execution of the work of the contract or a distinct element of the work ... by actually performing, managing, and supervising the work involved."

The question contract administrators often face is, "What are the management, supervision, and performance actions of a certified firm that satisfactorily meet this requirement?" Evaluating these areas will form the basis for determining that a certified firm has, in fact, performed a CUF. The contract is the one key reference point for any contract administrator and it is essential for this evaluation process. The contract (as well as its subsequent change orders and addenda) must be a legally recognized document and include an effective description outlining the work the certified firm is to perform.

USDOT regulations identify the following key factors to analyze when determining whether a certified firm is performing a CUF:

- Evaluation of the scope of work subcontracted and whether it is consistent with normal industry practices;
- Whether the amount the firm is paid under the contract is commensurate with the work that is actually being performed to be credited towards the goal;
- When the certified firm furnishes materials, the firm must be responsible for negotiating the price, determining the quality and quantity of the material, ordering the material, and paying for the items. A contracting agency would typically hire a certified firm to both furnish and install the material with its own labor force; and
- Whether the certified firm's role is limited to that of an extra participant in a transaction, contract, or project in which a non-qualifying individual and certified firm passes funds in order to obtain the appearance of certified firm participation. In essence, did the non-qualifying individual and certified firm establish the working relationship as a contrived arrangement solely to meet the certified firm contract goal?

When determining whether a certified firm is an extra participant, you must examine similar transactions, particularly those performed by non-certified firms. A certified firm must play a necessary and useful role in the transaction for which there is a market outside the context of the program. The firm's role must not be a non-essential step created in an attempt to obtain credit towards the goal.

Normal Industry Practice

One of the most important elements of a CUF review is determining whether the firm's role on the project is consistent with "normal industry practice." This means the contracting agency must determine if the certified firm is performing the work or services in the manner normally performed by all contractors, both certified and non-certified firms. However, even if a certified firm is performing work pursuant to normal industry practices, if those practices erode the ability of the certified firm to control the work and remain independent, this may affect how much can be credited toward the goal and may raise questions about the certified firm's eligibility.

One general rule of thumb when performing this analysis is to consider whether a certified firm would function in the same manner if certification programs did not exist. When determining what constitutes normal industry practice, the contracting entity must consider if the certified firm also performs this work within the private sector.

Monitoring

In keeping with normal contract requirements, it is the primary responsibility of the contracting entity or prime contractor to ensure that the certified firm is performing a CUF. On projects using a prime contractor, the contracting entity issuing the contract ultimately has the burden to ensure that the prime contractor has effectively met this responsibility under its contract.

Contractors, certified firms, local public agencies, and all employees are required to cooperate in carrying out this responsibility. The contracting entity should establish and enforce monitoring procedures that include the following:

- Clearly written directives defining the role and interrelationship of departmental staff responsible to monitor and evaluate the certified firm's compliance within the contract provisions;
- Procedures that spell out specific monitoring activities and responsibilities of a project-level monitoring program;
- Exchange of information between departmental, central, and field offices by reporting accomplishments, violations, and enforcement;
- Timely notification of COBID regarding investigations of failed CUF reviews; and
- The contracting agency shall implement application of appropriate sanctions if the agency determines that the certified firm has failed to meet the contract requirements.

Certified Firm Performance—CUF

This section provides overview of typical CUF-related questions and a list of documents to review.

To determine whether a certified firm performs a CUF, the analysis should include five (5) distinct aspects of a certified firm's involvement on the job or contract: 1. management, 2. workforce, 3. equipment, 4. materials, and 5. performance.

A contracting entity, in making a CUF determination, must evaluate the certified firm's performance on a case-by-case basis.

1. Management

The certified individual must supervise daily operations of the firm. The certified individual may personally perform the supervision, or designate a full-time, skilled, and knowledgeable employee. The certified firm must pay the supervising employee and the individual must be present on the job site and under the certified owner's direct supervision. The certified individual must make all operational and managerial decisions for the firm. Mere performance of administrative duties does not meet the requirements of supervision of daily operations.

The certified firm must manage the work contracted to the firm. Management includes, but is not limited to:

- Scheduling work operations;
- Ordering equipment and materials;
- Signing contracts and change orders;
- Attending pre-bid meetings;
- Preparing and submitting certified payrolls; and
- Hiring and firing employees.

Red Flags

Red flags related to management operations, warranting further review, may include:

- The certified individual or designated employee provides little or no supervision of the work;
- The designated employee is not a regular employee of the firm or supervision is performed by personnel associated with the prime contractor or another business;
- Key staff and personnel are not under the control of the certified individual;
- The certified firm's owner is not aware of the status of the work or the performance of the business; and
- The prime contractor or another individual not employed by the certified firm responds to the contracting entity's inquiries.

Typical CUF questions could include:

- Is there a written, legal document executed by the certified firm that outlines specific elements of work performed by the firm?
- To whom does the on-site employee report and how frequently?
- Has this individual(s) received payment from any other contractor during the course of the project?
- Has the certified owner been present on the job site?

Typical documentation to evaluate:

- Written contract
- Daily inspection reports and project diaries
- Payrolls (certified and regular)

2. Workforce

In order to consider a certified firm independent, the certified firm must keep a regular workforce. Certified firms cannot continuously "share" employees with non-certified individuals or businesses. The certified firm must perform a minimum of **30%** of the work with a workforce the certified individual controls. Employees may include those hired by the firm from a source such as a labor union. The certified individual, in all instances, must have direct supervision over all of his or her employees.

The certified firm must be responsible for payroll and labor compliance requirements for all employees performing on the contract. It is the expectation that the certified individual prepares and finances the payrolls. Prohibited conduct includes direct or indirect payments by any other contractor or non-qualifying individual to the certified firm's standard industry workforce expenses.

The certified firm must not subcontract a greater portion of the work than would be expected for the type of work involved in normal industry practice.

Red Flags

Red flags related to workforce practices, warranting further review, may include:

- Supervision/direction of the certified firm's employees by another contractor;
- Actual work is performed by personnel normally employed by the prime contractor or another business; and
- The certified firm and the prime contractor, or another non-qualifying individual, pay the employees.

Typical CUF questions could include:

- Who prepares the certified firm's payroll?
- Have any other firms working on the project included the certified firm's employees on their payroll?
- Who does the certified firm's on-site designated employee contact for hiring, firing, or modifying the contract due to site condition changes or change orders?
- Asking the certified firm's employees who they report to and who signs their checks.

Typical Documents to evaluate:

- Signed contracts
- Daily inspection reports and project diaries/logs
- Payroll records
- Copies of cancelled checks, if necessary

3. Equipment

A certified firm may lease specialized equipment from a contractor, **excluding the prime**, if it is consistent with normal industry practices and at rates competitive for the area. The lease must specify the terms of the agreement. The lease must be for a limited time and must involve a specialized piece of equipment for use at the job site. The lease may include an operator for the equipment who remains on the lessor's payroll if this is a generally acceptable practice within the industry. The operation of the equipment must be subject to the full control of the certified individual.

It is the expectation that the certified firm provides the operator for non-specialized equipment and is responsible for all payroll and labor compliance requirements. There must be a lease for the equipment. If the certified firm also leases an operator, the firm must obtain the operator through a separate lease. Both leases must include a description work performed and the charges for the services. The certified individual or a supervisor employed and controlled by the certified individual must sign all lease agreements. Typically, the contracting entity approves all lease agreements prior to the certified firm starting the work.

On a case-by-case basis, the contracting entity may approve the certified firm to lease a specialized piece of equipment from the prime. However, the contracting entity must ensure not to count the lease amount toward the contract goal. It is prohibited conduct for the prime to lease equipment to the certified firm and deduct payment for its use from the prime contractor's total payment(s) to the firm.

Red Flags

Red flags related to equipment practices, warranting further review, may include:

- Equipment the certified firm uses belongs to the prime contractor or another contractor, with no formal lease agreement in place or at a discount atypical to the industry;
- The certified equipment signs and markings cover another owner's identity, usually through the use of magnetic signs; and
- A certified trucking business uses trucks owned by the prime contractor.

Typical CUF questions could include:

- Obtaining a list of the major heavy equipment used by the certified firm and verify whether firm owns the equipment.
- Does the certified firm own or lease the equipment?
- If leased, is there an agreement signed by the certified firm and lessor identifying the terms and parties involved?
- Does the equipment have the certified firm's markings or emblems?
- Is the equipment under the direct supervision of the certified firm? Where is it stored?
- Is the operator of the leased equipment the certified firm's employee?
- If leased, does the prime contractor or other non-qualifying individual deduct payment for the equipment from the work performed?

Typical Documents to evaluate:

- Written contract
- Daily inspection reports and project diaries/logs
- Leases
- Vehicle registrations
- Verification of equipment ownership

4. Materials

For a certified firm to receive credit for supplying materials (furnish and install), the firm must perform the following four functions:

- (1) Negotiate price;
- (2) Determine quality and quantity;
- (3) Order the materials; and
- (4) Pay for the material itself.

If the certified firm does not perform all of these functions, it has failed to perform a CUF with respect to obtaining the materials. If there is a failed CUF, the payment(s) for materials and work performed do not count toward the overall goal. The certified firm should show as the payer for the materials.

While the regulations and guides, such as this one, tell recipients to consider normal industry practices, this does not overrule the requirement that the certified firm must perform the four functions enumerated above. Even if standard industry practices prohibit subcontractor performance of all four functions, the "furnish" portion of the transaction does not lend itself to the performance of a CUF and a contracting entity may not give credit for the acquisition or cost of the materials. Example: Manufacturers will only negotiate with a prime, thereby eliminating the certified firm's ability to negotiate the price while the firm does participate in the logistics of delivering and supplying the materials. In this case, even in light of the industry practice limiting the extent of the certified firm's participation, the certified firm does not ultimately perform a CUF.

Red Flags

Red flags related to material supply practices, warranting further review, may include:

- Materials for the certified firm are ordered or paid for by the prime contractor or another firm;
- Two-party checks or joint checks are sent by the prime to the supplier or manufacturer instead of originating from the certified firm;
- Materials or supplies necessary for the certified firm's job performance are delivered to, billed to, or paid for by another business;
- Materials are delivered to the job site by a third party unless delivery by another firm is consistent with industry practice (e.g., concrete delivery);
- The prime contractor deducts its own direct payment to supplier for materials from payments to the certified firm for work performed; and
- A certified firm acting as a prime contractor only purchases materials while performing little or no work.

Typical CUF questions could include:

- Is there a written contract executed by the certified firm to perform a distinct element of work?
- Who makes arrangements for delivery of materials?
- Who are the firm(s) listed on the material invoices?
- What is the method of shipment for the materials?
- Who actually delivered the materials? Were they delivered to the job site or another location first?
- If two party checks are used, who is the payee on the checks?

Typical Documentation to evaluate:

- Written contracts
- Delivery tickets
- Invoices
- Daily inspection reports and project diaries
- Payments for materials and delivery

5. Performance

The certified firm must be responsible for the performance, management, and supervision of a distinct element(s) of the work, in accordance with normal industry practice.

Red Flags

Red flags related to performance practices, warranting further review, may include:

- Work is being done jointly by the certified firm and a non-qualifying contractor;
- The work to be performed by the certified firm is outside of the certified individual's known experience or capability;
- A prime contractor or non-qualified individual performs any portion of the work designated to be performed by a certified firm;
- The certified firm is working without a subcontract approved by the department, except in the case of trucking;
- A certified firm, acting as a prime contractor, subcontracts more than 50% of the contract value to non-certified firm(s);

- The agreement between the prime contractor and certified firm artificially inflates the certified firm's participation;
- An agreement that erodes the ownership, control, or independence of the certified firm;
- A certified firm works for only one prime contractor, or a large portion of the firm's contracts are with one contractor; and
- The volume of work is beyond the certified firm's present capacity.

Typical CUF questions could include:

- Does the certified firm's on-site representative effectively manage the job site without any interference from a non-qualifying individual?
- Does the certified firm appear to have control over execution of work on its contract items?
- Is the certified firm actually scheduling work activities, material deliveries and other related actions required for execution of the work?
- Has any other contractor (regardless of their certification status) performed any amount of work specified in the certified firm's contract?

Typical Documents to evaluate:

- Written contract
- Daily inspection reports or project diaries

Trucking Firms

A certified firm providing trucking services must own and operate at least one fully licensed, insured, and operational truck used on the contract. To perform a CUF, a certified firm must also be responsible for the management and supervision of the entire trucking operation or a specified portion of the trucking operation to which it has been committed. There cannot be a contrived arrangement simply to meet a contracting entity's goal.

A certified firm can supplement its fleet by leasing a truck(s) from an established equipment leasing business open to the public. The lease must indicate that the certified firm has exclusive use of and control over the truck. This requirement does not preclude the leased truck from working for others during the term of the lease with the consent of the certified firm, so long as the lease gives the certified firm absolute priority for use of the leased truck. Otherwise, the certified firm does not receive full credit for goal participation.

Leased trucks must display the name and identification number of the certified firm on the vehicle. The certified trucker must also hold the necessary license, hauling permit, etc., as required by the state to transport material on public highways.

To count the value of trucking services the certified firm provides toward a contract goal, the following can occur:

- The certified firm may lease trucks from another certified firm, including on an owner-operator lease basis. The certified firm can count the entire value of services performed by these trucks.
- The certified firm may also lease trucks from non-qualifying individuals and owner operators. However, the certified firm can only count the value of these trucking services used on the contract up to the value of services performed by the trucks owned and leased on a 1:1 ratio.

In order for the contracting entity to monitor the performance of a certified individual's trucking firm, the work performed must be in the subcontract and approved by the contracting entity prior to execution of the work. The certified firm must also provide a valid equipment or operator lease to the contracting entity as additional documentation to support the contract prior to its approval. To be considered valid, the lease must include such items as the lessor's name, list of trucks to be leased by vehicle identification number (VIN), and the agreed upon amount of the cost and method of payment between the lessor and lessee. It should be the responsibility of the certified firm to provide the fuel, maintenance, and insurance for all leased trucks.

Typical CUF questions could include:

- Do the trucks used on the project belong to the certified firm?
- Is there a formal lease identifying the terms and parties?
- Are the rates appropriate?
- Is there an approved subcontract?
- If so, who are the parties?
- Does the certified firm's payroll reflect the employees performing the work?

Typical Documentation to evaluate:

- Subcontracts
- Leases
- Payroll records
- Daily inspection reports and project diaries

Regular Dealers

In order for a certified firm to operate as a regular dealer, it must perform a CUF, and must comply with other requirements applicable to regular dealers. It must be an established business engaging in the purchase and sale or lease of the products in question. The principal place of business must be under the certified individual's name or the business' name.

A regular dealer is a firm that owns, operates, or maintains a store, warehouse, or other establishment. A certified firm shall buy, keep in stock, and regularly sell or lease to the public in the usual course of business all materials, supplies, articles, or equipment described by the specifications and required under the contract. Exceptions noted below.

It is important to make a distinction between a regular dealer and a firm that supplies a product on an *ad hoc* basis in relation to a particular contract or contractor. A regular dealer has a regular trade with a variety of customers. One of the key considerations when considering a regular, established dealer is the presence of an inventory of materials and/or supplies. A regular dealer assumes the actual and contractual responsibility for the provision of the material and/or supplies.

A firm may be a regular dealer in bulk items such as petroleum products, steel, cement, gravel, stone, or asphalt without owning, operating, or maintaining a place of business if the firm both owns and operates distribution equipment for the products. Any supplementing of regular dealers' own distribution equipment shall be by a long-term lease agreement and not on an *ad hoc* or contract-by-contract basis.

If a certified firm meets the requirements of a regular dealer, 60% of the cost of the materials, if reasonable, may count toward the contract goal. Packagers, brokers, manufacturers' representatives, or other persons who arrange or expedite transactions are not regular dealers.

Typical CUF questions could include:

- Does the regular dealer have an established storage facility and inventory?
- Does the dealer have a business that sells the product to the public on a routine basis?
- Does the business normally stock the product(s) for use on projects?
- Who is delivering and unloading the material on the job site?
- Does the certified firm own or lease the distribution equipment used in delivering the product?
- For bulk items, where does the material come from? Does the certified firm have a distribution agreement?

Typical Documentation to evaluate:

- Purchase Orders
- Invoices
- Distribution Agreement
- Delivery Tickets

Manufacturers

As described in 49 CFR § 26.55(e)(1)(ii), a manufacturer is a firm that operates or maintains a factory or establishment that produces on the premises materials, supplies, articles, or equipment required under the contract and as described by the specifications. Examples of such items include a concrete ready mix plant, a crushing operation, or a steel or concrete fabricating plant.

Typical CUF questions could include:

- Is the business's primary function to manufacture construction products?
- Does the business supply the product for this project as a normal stock item?
- Does the certified firm control the quality of the materials? Does it bear responsibility for quality control issues?
- Does the certified firm purchase the raw material used in its plant?

Typical Documents to evaluate:

- Purchase orders
- Detailed list or receipt of a shipment of goods given by the carrier to the person consigning the goods
- Shipping tickets and invoices

Sanctions for Compliance and Enforcement

The prime contractor is also responsible for ensuring that a certified firm performs a CUF. If the project does not involve a prime contractor, it is the responsibility of the contracting agency to ensure the certified firm performs a CUF. Failure of a certified firm to perform a CUF should result in the contracting entity taking specific, definitive actions to enforce the CUF requirement of the contract. See ORS 200.065 and .075. Some of the actions include but are not limited to the following:

- Deny or limit credit towards the contract goal;
- Suspend the firm from future projects per ORS 200.075;
- Require the prime to make good faith efforts to replace the certified firm in an effort to meet the goal on remaining work;
- Withhold progress payments;
- Terminate the contract; and
- Reduce the contractor's prequalification limit.

Some questions that could be part of an evaluation procedure:

- If the firm did not perform a CUF, what action did the contracting entity and/or prime contractor take to correct the deficiency?
- Did the contracting entity or prime contractor notify the certified firm of the failed CUF and provide the certified firm an opportunity to explain and/or fix the deficiency?
- Did the action taken by the certified firm correct the deficiency?
- Has the firm failed multiple CUFs?

List of Typical Documentation to Collect:

- Executed contracts
- Material/supply agreements
- Invoices of materials/supplies
- Equipment titles of ownership
- Equipment lease/rental agreements
- Hauling tickets
- Delivery tickets
- Canceled checks
- Project inspection/diaries
- Payroll records

When a presumption arises that the certified firm is not performing a CUF, the certified firm may present evidence to rebut this belief. Decisions regarding CUF determinations are subject to review by concerned operating administrations, such as COBID. However, CUF decisions are not appealable to COBID; they are contract administration issues and the certified firm may only appeal to the contracting agency.

CUF & Certification

Certification process and CUF review are separate and distinct issues. Certification decisions address the nature of a firm's ownership, structure, and management and control while CUF review relates to the certified firm's responsibility for execution of the work of the contract and is actually performing, managing, and supervising the work involved. Even if the certification process has identified the certified firm's ability to perform a service, it is important to review and determine what and how a certified firm actually performs throughout the course of the contract.

A certified firm's repeated failure to perform a CUF may raise questions regarding control, as it relates to independence and ownership. If there is evidence of a pattern of failing to perform a CUF, the contracting entity shall notify COBID if the entity performs an investigation for failing to perform a CUF. A contracting entity may commence a proceeding under 49 CFR § 26.87 to determine the continued eligibility of the certified firm.

In cases of deliberate attempts to circumvent the intent of the certification programs, or fraud, these actions may lead to criminal prosecution of both the certified and prime contractor (if applicable). If a contracting entity suspects fraud, the entity should contact the COBID.